



Interim presentation: Options to make Virginia's individual income tax more progressive (HJ 567)

HJ567 (2021) directs JLARC to study the progressivity of Virginia's individual income tax

- Evaluate the fiscal impact of changes that would make Virginia's individual income tax more progressive
 - tax brackets
 - tax rates
 - credits, deductions, & exemptions
- Identify potential changes to the Code of Virginia or Virginia Tax regulations
- Staff currently planning to present final report at September 2022 JLARC meeting

Research activities

- Reviewing academic literature on tax policy
- Analyzing Virginia's tax system & filing data
- Comparing Virginia's tax system to other states
- Identifying potential options to make Virginia's individual income tax more progressive
- Working with Virginia Tax to model impact of options

In this presentation

Background

Definition and preliminary analysis of progressivity

Elements of Virginia's tax affecting progressivity

Next steps

Virginia has levied an individual income tax for more than 175 years

- 1843: 1% tax on salaries above \$400
- Early 1860s: rate increase to help finance war
- 1948: 2%, 3%, and 5% brackets established
- 1972: 5.75% bracket added
- 1990: income thresholds increased

Virginia's income tax is a relatively small share of total federal, state, & local taxes

- Limits Virginia income tax effect on overall tax progressivity
- Federal income tax is largest liability for most filers
 - Federal tax brackets & rates much higher than Virginia's
- Most Virginians also pay other taxes
 - Federal: Social Security (6.2%), Medicare (1.45%)
 - State: sales tax, excise taxes (gas, alcohol, tobacco)
 - Local: property taxes on residences & vehicles

Virginia's individual income tax rates increase along with taxable income

Taxable Income	Rates
\$0 to \$3,000	2%
\$3,001 to \$5,000	3% <i>(plus \$60)</i>
\$5,001 to \$17,000	5% <i>(plus \$120)</i>
More than \$17,000	5.75% <i>(plus \$720)</i>

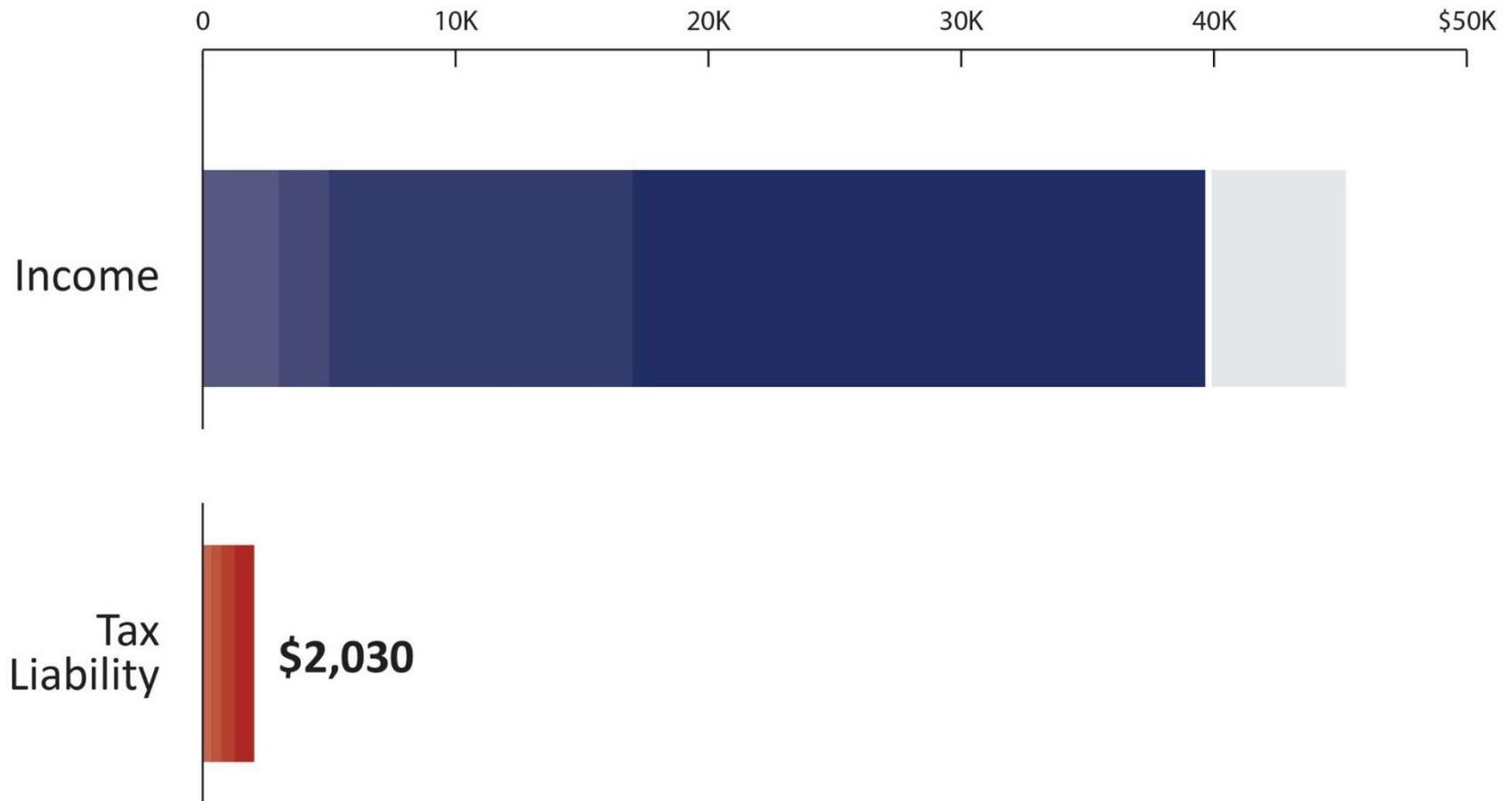
Single filing threshold = \$11,950

Married filing jointly threshold = \$23,900

Virginia allows a variety of deductions, exemptions, & credits

Standard deductions	Single filer	\$4,500
	Married filing jointly	\$9,000
Exemptions (example)	Self and spouse	\$930
Other deductions & credits (examples)	Age 65 & older deduction	Up to \$12,000 if single and \$24,000 if married
	Child & dependent care expenses deduction	Up to \$3,000 for 1 child, \$6,000 for 2 or more
	Credit for Low-Income Individuals / VA Earned Income Credit	\$300 per personal & dependent exemption / 20% of federal EITC

Example: Tax liability for single filer with adjusted gross income of \approx \$45K



Nearly 4 million individual income tax returns were filed in 2018*

- Most filers (94%) were Virginia residents
- Majority of filers were single (58%)
 - married filing jointly (38%)
 - separately (4%)
- About 10% of Virginia households did not file because their income was below the state's filing threshold**

*2018 is the most recent tax year for which complete individual income tax data is available.

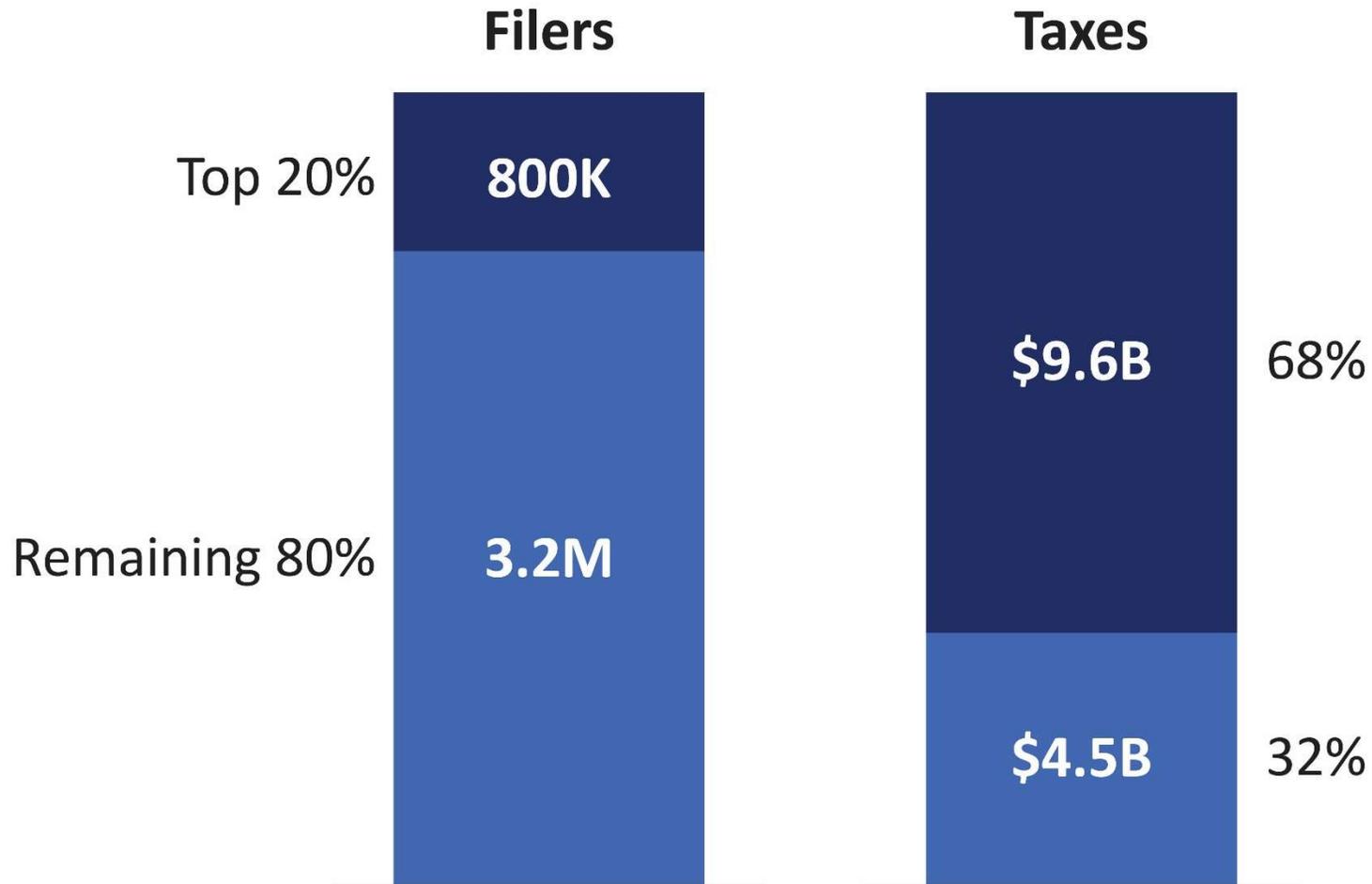
**Analysis of Current Population Survey data.

Individual income tax is state's largest source of general fund revenue

- Individual income tax revenue comprised 73% of all general fund revenue in 2020 (\$15.3B of \$20.9B)
- Individual income tax revenue as share of total general fund has increased from 40% in 1980, 54% in 2000

Sources: Virginia Tax 2020 Annual Report, data for FY19; Bowman 2002.

Top 20% of filers pay 68% of all state income tax



Source: JLARC analysis of 2018 Virginia tax returns.

In this presentation

Background

Definition and preliminary analysis of progressivity

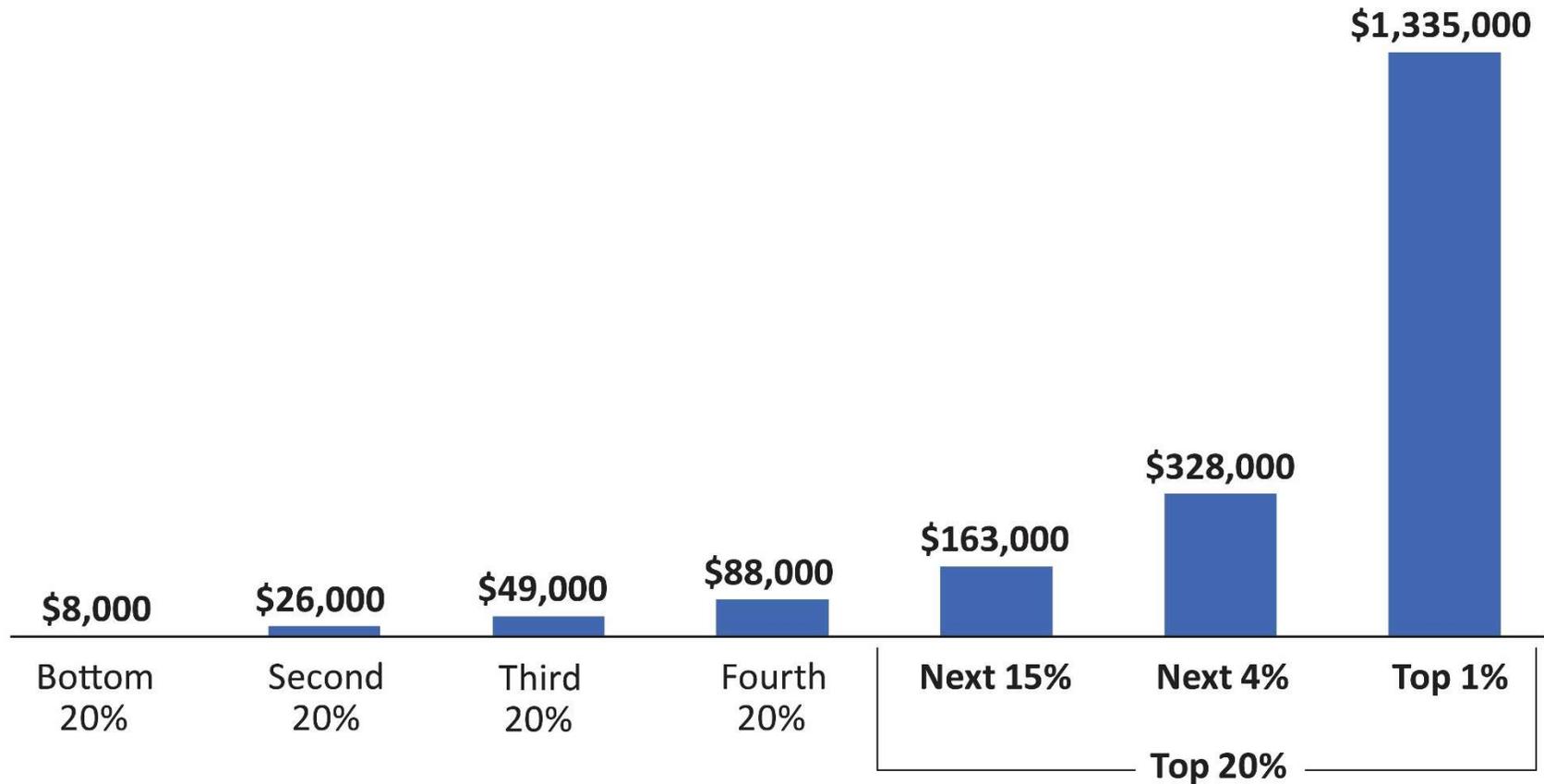
Elements of Virginia's tax affecting progressivity

Next steps

Ability to pay is key principle underlying tax progressivity

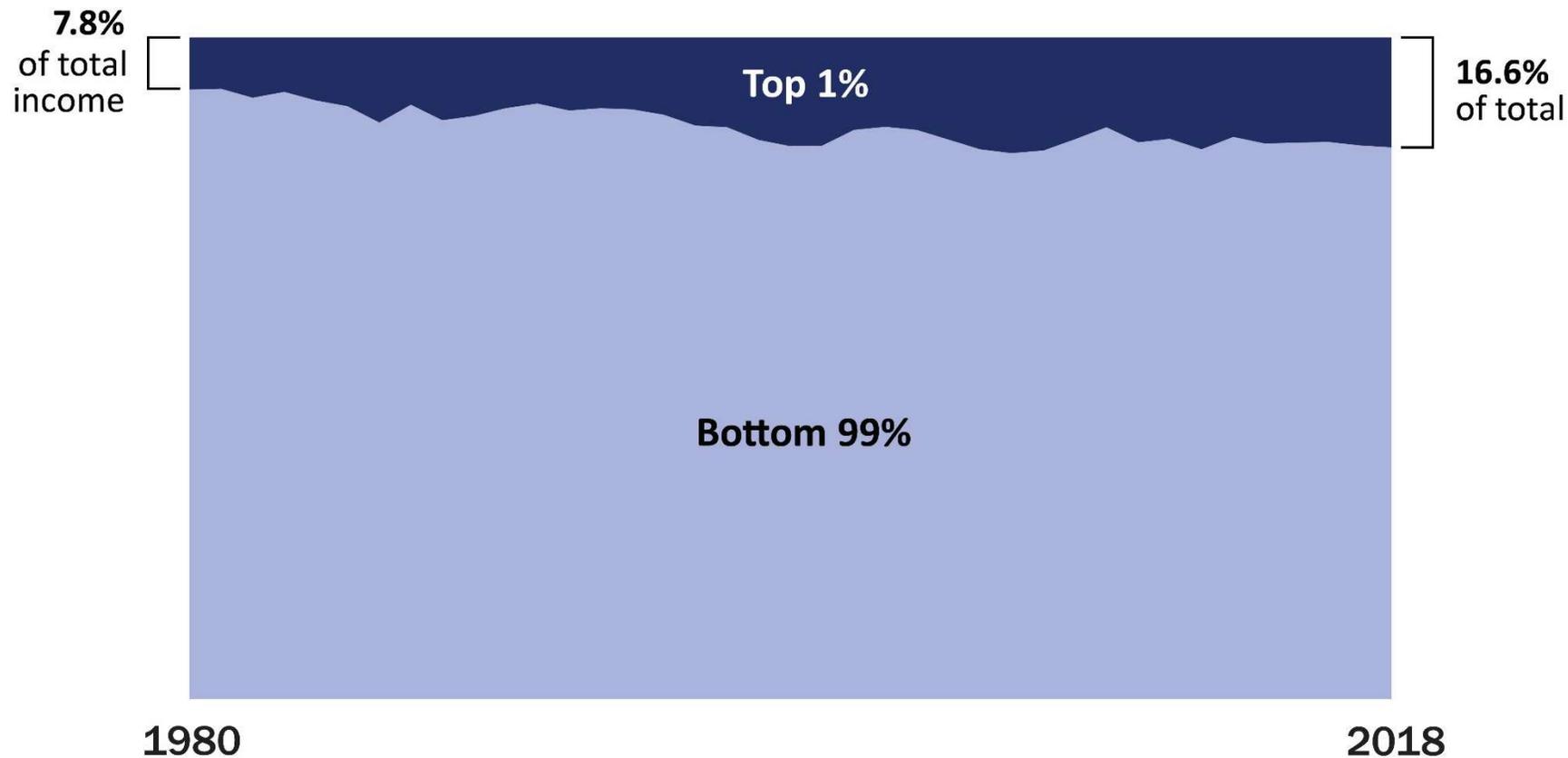
- Lowest income filers have much less ability to pay taxes than the highest income filers
- Income inequality is frequently cited by proponents of tax progressivity as reason for progressive tax systems

Substantial differences in income among Virginia filers, especially among the top 20%



Source: JLARC analysis of 2018 Virginia tax returns. Excludes part-year and nonresident filers, and non-filers.

Top 1% of Virginians' share of total income has more than doubled (1980–2018)



Source: IRS Statistics of Income and CPS data, World Inequality Database.

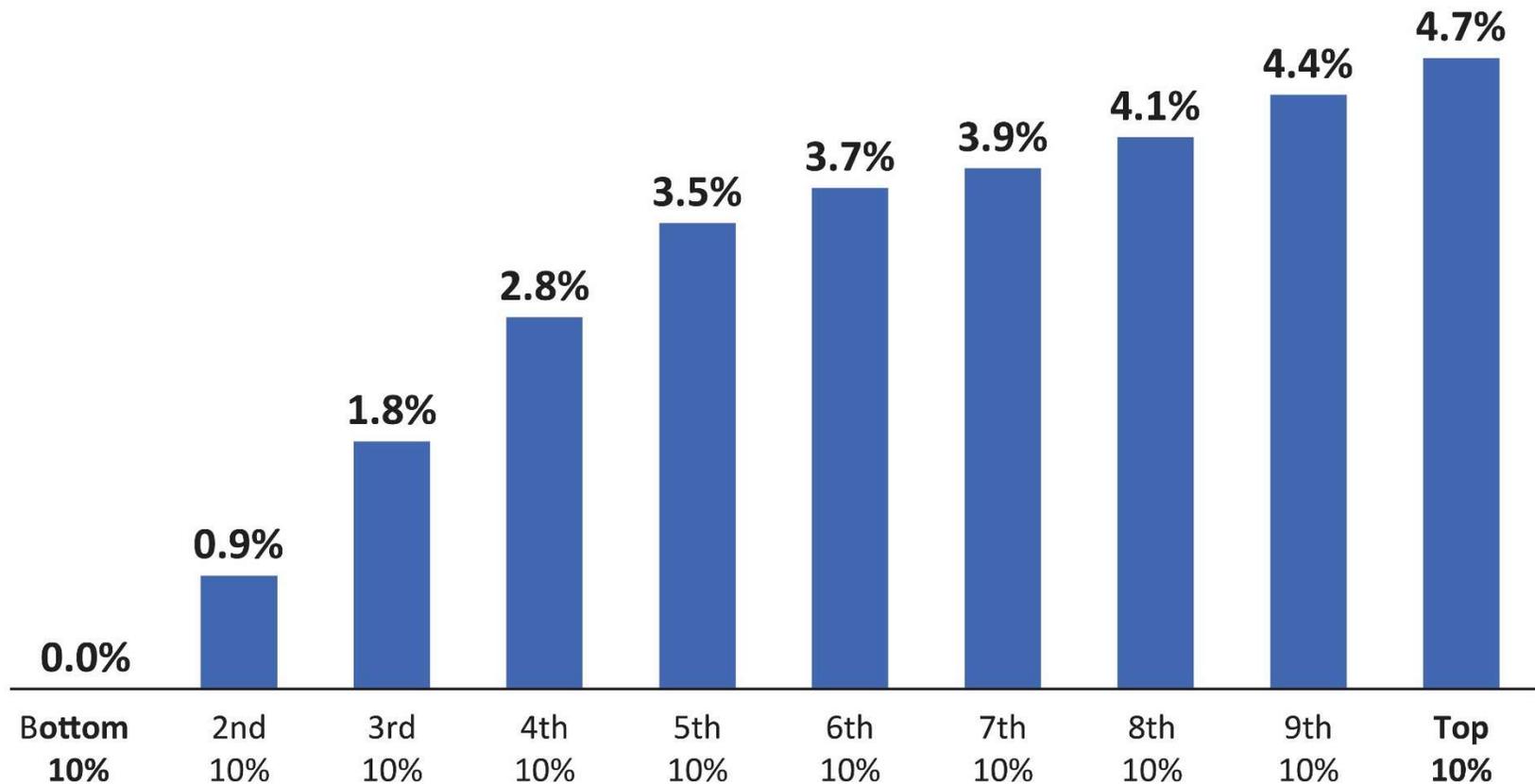
A progressive tax means high income households pay higher tax rates than lower income households

- Analyzing only statutory tax rates and income brackets to assess progressivity can be misleading because of deductions, credits, & exemptions
- Effective tax rates (ETR) paid by each income grouping measure tax progressivity more accurately
 - Gross, not taxable income
 - Rates, not dollar amount of tax

Tax experts use various approaches to measure the *degree* of progressivity

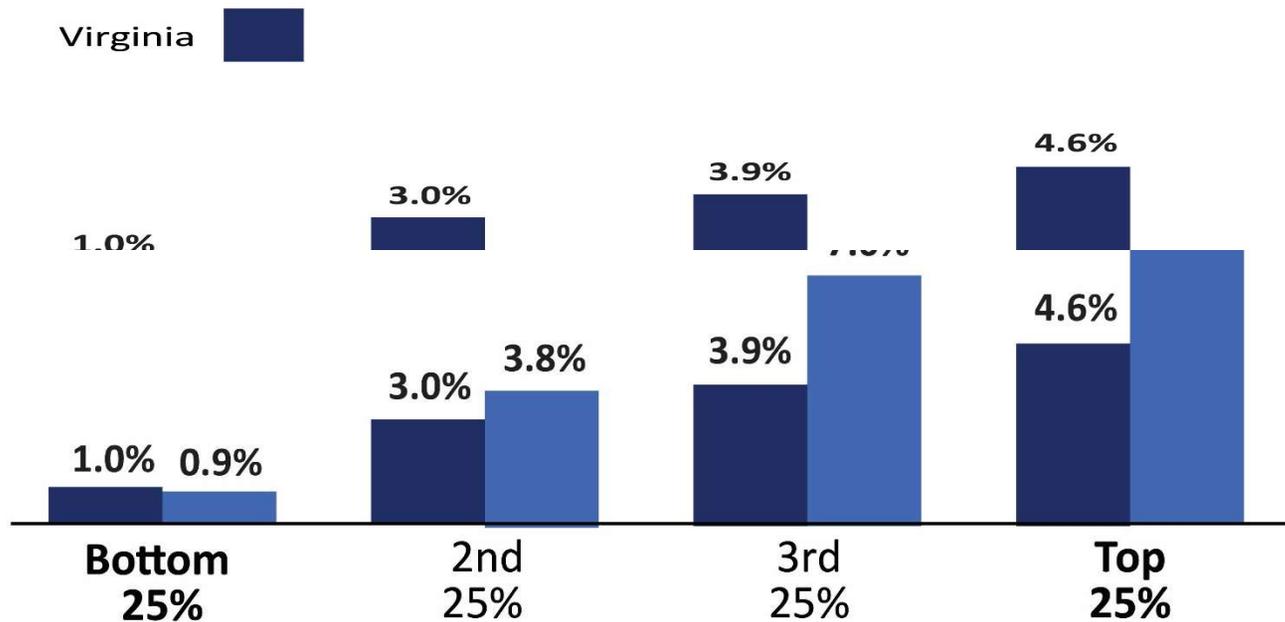
- “Slope” of ETRs among income groupings (quartiles, quintiles, deciles, etc.)
- The difference in ETRs between the top 1% and the bottom 20% (ETR Gap)

Virginia's personal income tax is progressive



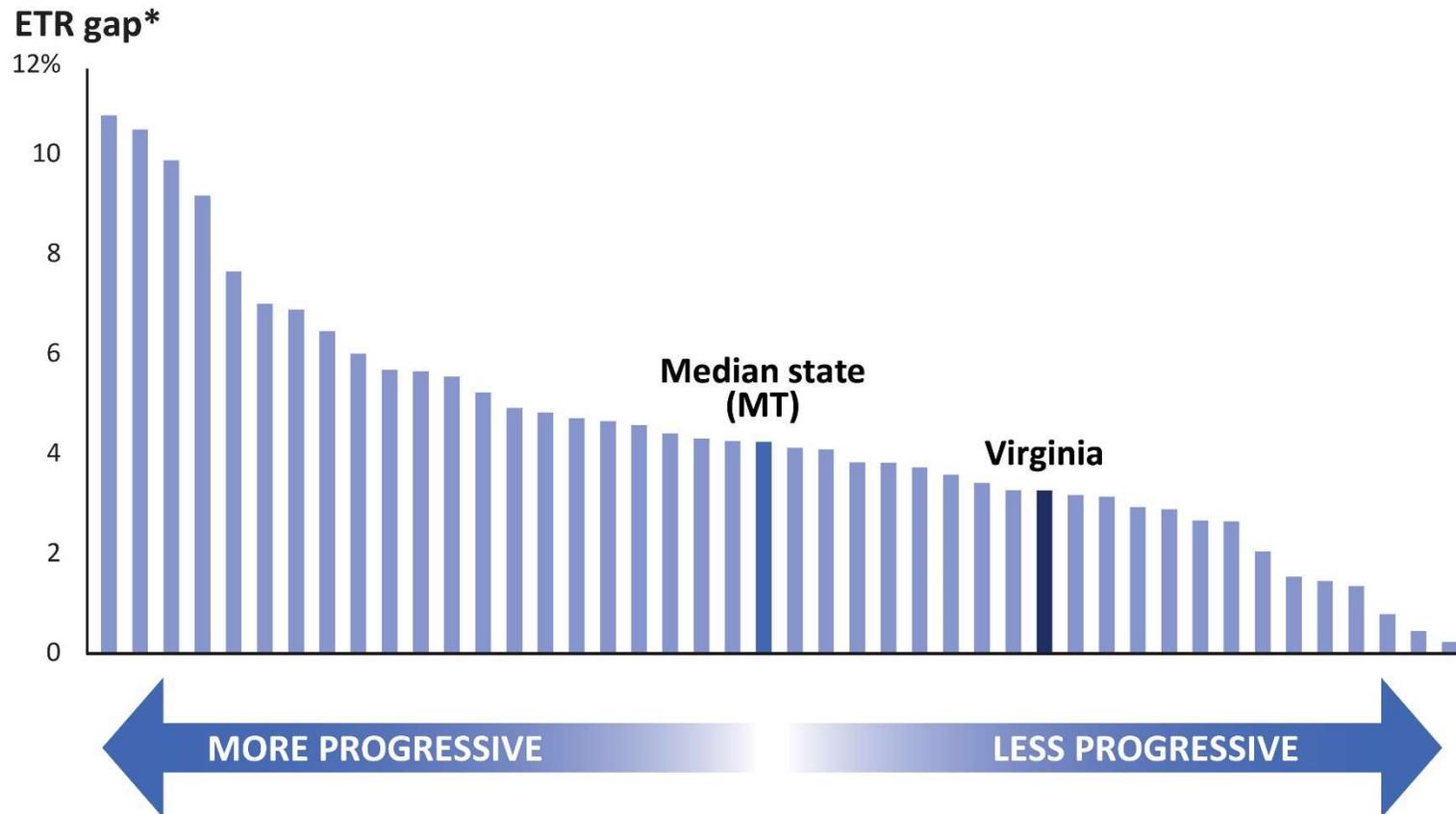
Source: JLARC analysis of 2018 Virginia tax returns. Excludes part-year and nonresident filers, and non-filers.

Federal individual income tax is more progressive than Virginia's tax



Percentages equal effective tax rates. JLARC analysis of 2018 Virginia tax returns, excluding part-year, nonresident, and non-filers and 2018 IRS Statistics of Income for U.S.

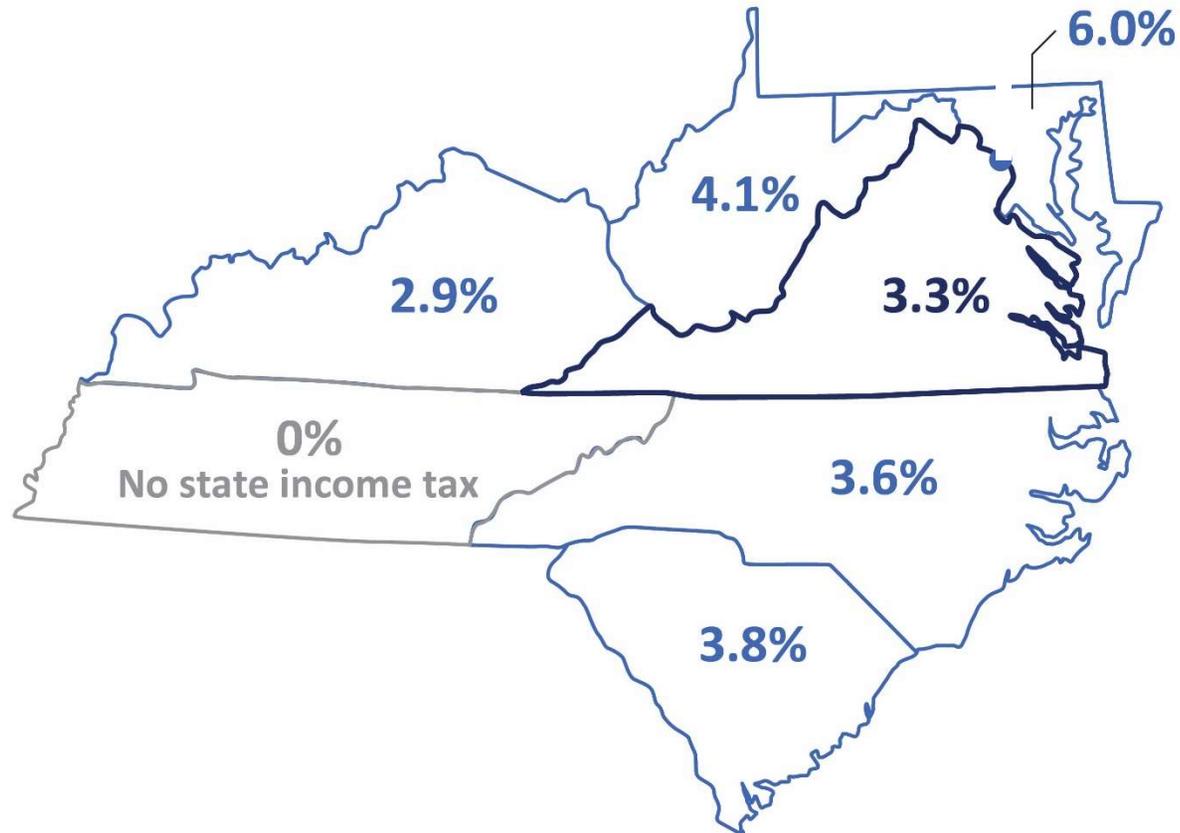
Most states have more progressive individual income taxes than Virginia



Source: Institute on Taxation & Economic Policy (ITEP), 2018.

*ETR gap = percentage point gap in effective tax rate between the top 1% of taxpayers and the bottom 20%.

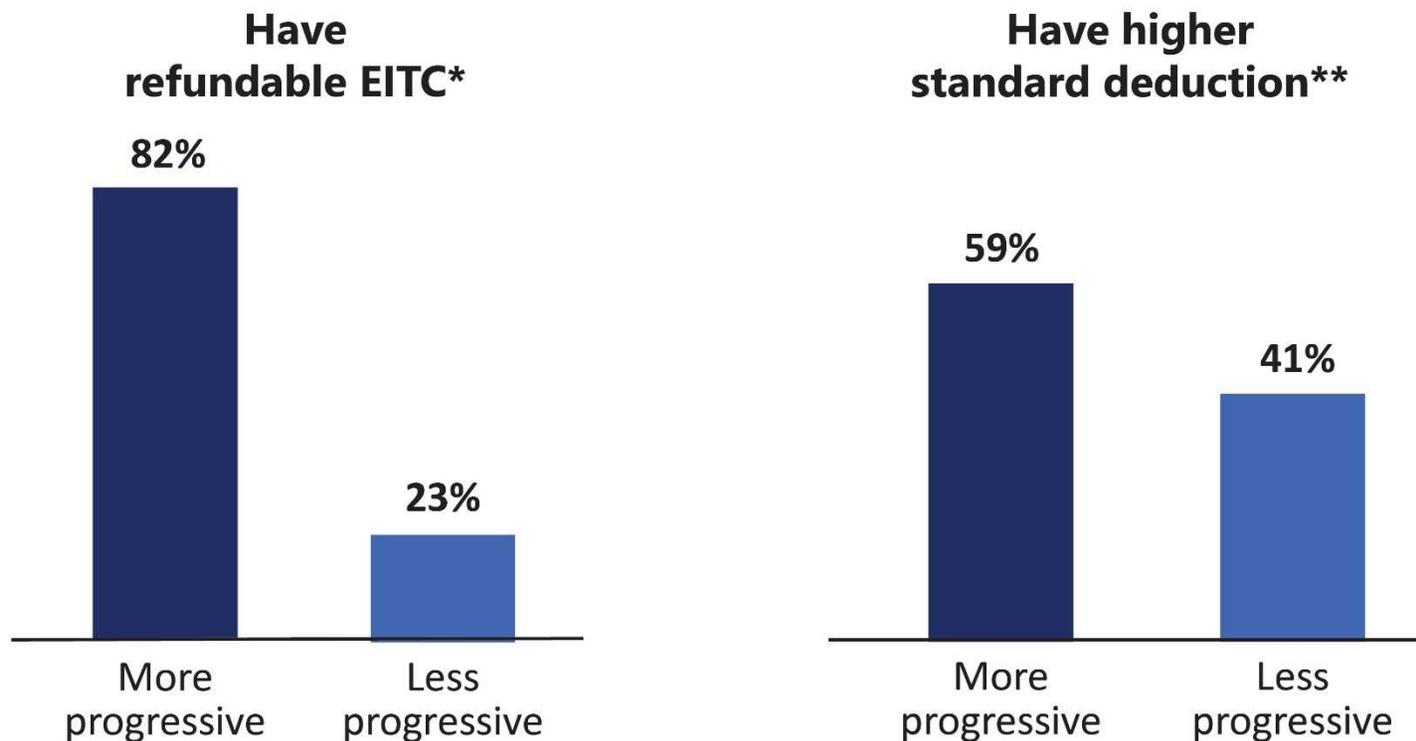
Several states in the region have more progressive income taxes than Virginia



%s shown are ETR gap (top 1% effective rate minus bottom 20% effective rate).

Source: Institute on Taxation & Economic Policy (ITEP), 2018.

States with more progressive income taxes tend to have larger credits and deductions



Source: ITEP, Federation of Tax Administrators, Urban Institute.

*EITC = earned income tax credit.

**Standard deduction is higher than the median standard deduction for states with individual income taxes.

In this presentation

Background

Definition and preliminary analysis of progressivity

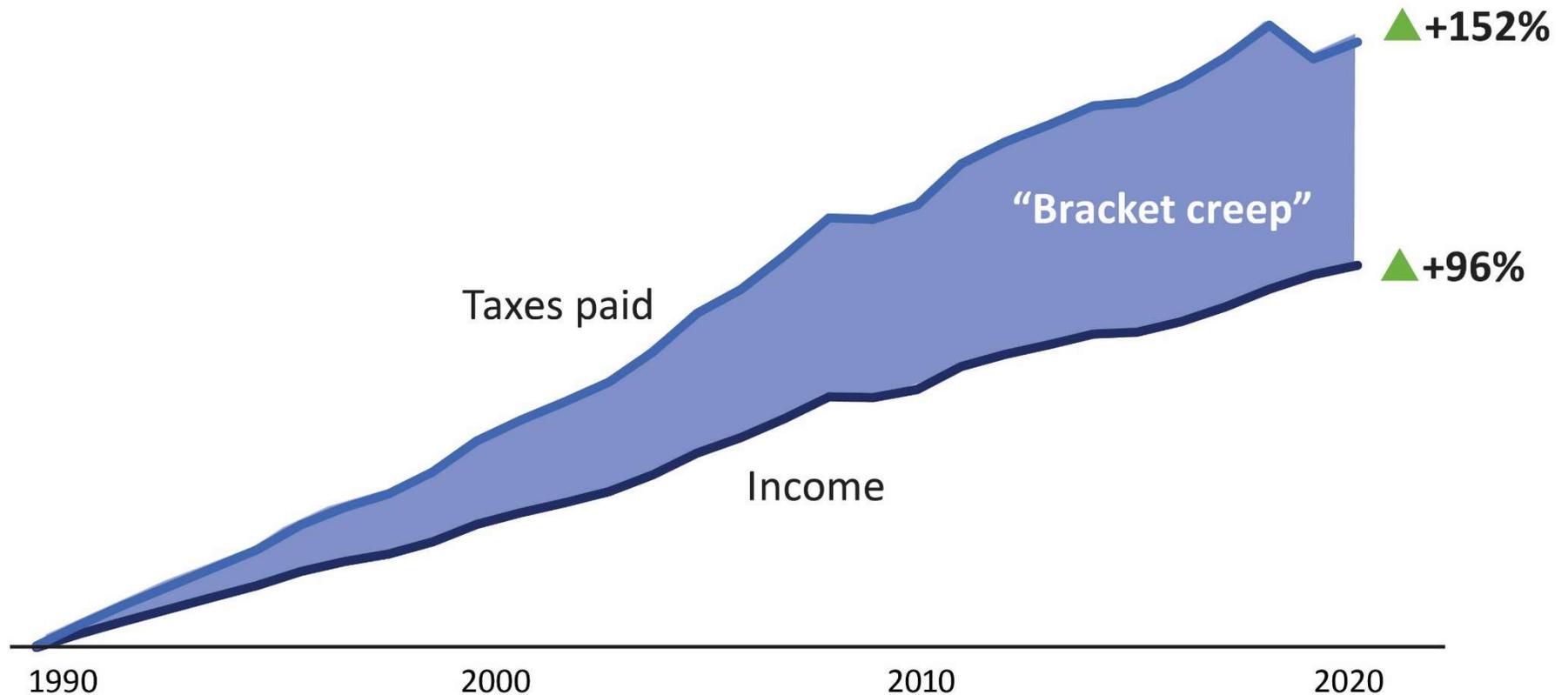
Elements of Virginia's tax affecting progressivity

Next steps

“Bracket creep” has made Virginia’s income tax less progressive over time

- Income tax brackets have not changed in ≈ 30 years
- Consequently, more Virginians are paying the highest marginal tax rate (5.75%) on a greater portion of their income—because of inflation—even if their real income has remained about the same
- Bracket creep affects all filers, but affects lower income filers the most because more of their income is now subject to highest marginal tax rate

Rising income due to inflation = more taxes being paid (when income brackets remain the same over time)



Note: Analysis based on a single filer in Virginia with median income in 1990.

Low-income tax credits increase progressivity

- Tax Credit for Low-Income individuals created in 2000, Virginia Earned Income Credit in 2006
- Reduce taxes owed for families in poverty and those receiving the federal EITC
 - 330,000 families (9% of all returns) claimed low income credits (2018)
 - Reduced tax liability to \$0 for more than 1/3 of these families

Source: JLARC analysis of 2018 Virginia tax returns. Excludes part-year and nonresident filers, and non-filers.

Raising Virginia's standard deduction and filing threshold have also increased progressivity

- Standard deduction for single filer increased from \$3,000 to \$4,500 (2019)
 - Reduced tax liability for most by \$86
 - All filers who don't itemize benefit from higher deduction
- Filing threshold increased from \$11,250 to \$11,950 (2012)
 - Allowed additional low-income filers to have \$0 tax liability

Age deduction for Virginians 65 and older increases progressivity

- Filers meeting age and income requirements* can claim the age deduction
 - \$12,000: single filers below \$50,000
 - \$24,000: married filers below \$75,000
- Age deduction claimed by 500,000 filers
- Reduced liability to \$0 for about 25% of those who claimed deduction

Source: JLARC analysis of 2018 Virginia tax returns. Excludes part-year and nonresident filers, and non-filers.

*Deduction for taxpayers age 65 and older born after 1939 is reduced \$1 for every dollar of income over \$50,000/\$75,000; taxpayers born prior to 1939 can claim the full amount.

In this presentation

Background

Definition and preliminary analysis of progressivity

Elements of Virginia's tax affecting progressivity

Next steps

JLARC staff will continue to research progressivity and identify options to increase it

- Continue to interview experts, conduct data analysis, review research literature
- Identify policy options to increase progressivity
- Work with Virginia Tax to estimate the revenue impact of each option, understand other impacts
- Monitor work of legislative joint subcommittee

Final report will primarily identify policy options for legislative consideration

- JLARC proposes policy options—rather than make recommendations—when
 - decision is a policy judgment best made by the General Assembly (or other elected officials)
 - addressing a report finding *could* be beneficial
 - there is insufficient evidence of a *single* best way to address a report finding
- Whether and how to change state income tax is a policy decision for the General Assembly
- JLARC may make technical recommendations if “good government” or sound tax policy issues arise

Questions? / Comments?

Justin Brown, Associate Director

Erik Beecroft, PhD, Chief Methodologist

Ellen Miller, Chief Analyst